
7. OTHER RISKS

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7.2 Pension risk

7.2.1 Definition

Basically, there are two types of pension plan:

- **Defined contribution plans**
In defined contribution plans, there is no guarantee that the employee will obtain a certain amount of pension benefits. The pension benefits depend on the size of the agreed contributions and developments in the return on invested pension funds and associated expenses. Accordingly, the employee bears the risk relating to the future pension benefits. The latter may change, for example, in the event of unfavourable developments in the financial markets related to the management of the pension assets. This means that the Group has no pension risk on defined contribution plans.
- **Defined benefit plans**
In defined benefit plans, the pension agreement contains a provision stipulating the pension benefit the employee will be entitled to receive on retirement. The benefit is typically stated as a percentage of the employee's salary immediately before retirement, but it can also be a percentage of the average salary during the entire period of employment. The pension benefit will typically be payable for the rest of the employee's life, which increases the employer's uncertainty about the amount of the future obligations.

The Group's pension risk is the risk of a pension shortfall in the Group's defined benefit plans which means that it will have to make additional contributions to cover its pension obligations to current and former employees. Such claims may arise, for example, as a result of changes in the underlying calculation parameters for the pension obligation.

The Group's defined benefit pension obligation is calculated as the discounted value of the pension benefits earned to date. The methodology of calculation is based on a number of assumptions:

Demographic factors	Financial factors
<ul style="list-style-type: none">• Mortality rate• Staff turnover rate• Disability rate• Early retirements	<ul style="list-style-type: none">• Interest rates• Future salary and benefit levels• Inflation rate• Expected return on plan assets

Defined benefit plans are especially exposed to interest rate and investment risks and increases in life expectancy because the pension benefits will typically be payable many years into the future.

7.2.2 Control and management

The Group's defined benefit plans are funded mainly by contributions made by the Group and the employees to separate defined benefit pension funds. The pension funds manage the assets by investing the contributed amounts so that the contributions and their returns cover future pension obligations. In addition, the Group has unfunded defined benefit pension plans that are recognised directly on the consolidated balance sheet.

The Group's defined benefit pension obligations consist of pension plans in Northern Ireland, the Republic of Ireland and Sweden as well as a number of small pension funds in Denmark. By far the majority of the Group's defined benefit pension schemes have been closed to new participants, but the schemes in Sweden and at National Irish Bank are still open to new members.

The use of financial derivatives to eliminate part of the inflation and interest rate risks is a cornerstone of the Group's risk management. By matching expected future pension benefits with the proceeds from the derivatives and the associated assets, the Group minimises its pension risk.

The high complexity of its pension obligations means that the Group does not use its normal limit structure to follow up on pension risk. Instead, the Group manages the market risk on pension plans on the basis of special follow-up and monitoring principles, so-called business objectives.

The Group has formulated procedures to be followed in the case of deviations from these objectives. The All Risk Committee has defined risk targets for the Group's pension funds. Quarterly risk reports follow up on the objectives, and they analyse the financial status of the individual plans on the basis of sensitivity analyses and the Value at Risk (VaR) measure. Furthermore, the Group has fixed limits for acceptable risk exposure levels.

On the basis of the average actuarial assumptions shown in the table below, the Group's total net exposure relating to defined benefit plans was DKr1.3bn at the end of 2007 against DKr1.6bn a year before.

DEFINED BENEFIT PLANS (DKr m)	2007	2006
Present value of unfunded pension obligations	145	144
Present value of fully or partly funded pension obligations	11,953	12,861
Fair value of assets under the plans	11,169	11,422
Net pension obligation at December 31	929	1,583
Actuarial gains/losses not recognised in the net pension obligation	376	34
Net pension obligation according to the IFRSs at December 31	1,305	1,617
Net pension obligations recognised on the balance sheet		
Pension assets recognised under Other assets	370	308
Pension provisions recognised under Other liabilities	1,675	1,925
Total	1,305	1,617
AVERAGE ACTUARIAL ASSUMPTIONS AT DECEMBER 31 (%)	2007	2006
Discount rate	4.8-5.8	4.1-5.2
Return on assets under the plans	5.0-7.1	4.6-7.2
Inflation rate	2.0-3.4	2.3-3.1
Salary adjustment rate	2.8-4.9	2.8-4.6
Pension adjustment rate	2.3-5.0	2.3-5.0

7.2.3 Use of models

The Group applies a number of widely differing calculation methods when determining its pension obligations. These methods reflect different pension obligation issues and serve separate purposes:

Methods	The pension fund's internal calculation	Consolidated financial statements based on the IFRSs	Capital management principles	Financial approach
Discount factor	Expected return on pension assets	Corporate bond with AA rating and the same duration as the obligation	Corporate bond with AA rating and the same duration as the obligation	Zero coupon yield curve/ Swap curve
Effect	Determines the level of the Group's contributions	The net obligation is adjusted for the corridor	Forms part of the capital base and the corridor method is not allowed	VaR is used as an indicator

The discount factor varies from one method to another.

The Group calculates market risk on defined benefit plans on a quarterly basis. For each pension plan, the calculations include net funding and the sensitivity of net funding to changes in interest rates, equity prices and life expectancy. Net funding expresses the difference between the market value of the assets and the present value of the pension obligations.

SENSITIVITY ANALYSIS (DKr m)			
	Change	Effect 2007	Effect 2006
Equity prices	-20%	-1,259	-1,375
Interest rates	+ 1/- 1percentage point	+ 1,304/-921	+ 1,794/-1,807
Life expectancy	+ 1 year	-380	-415

To supplement the sensitivity calculations, the Group calculates the risk in the individual pension funds, expressed as VaR. The calculations are based on a long-term horizon. In this scenario, share price volatility (20%) and the correlation between interest rates and share prices (25%) have been set at values reflecting normal market data. The duration of the pension obligations is reduced by half as, empirically, inflation risk reduces the interest rate risk on the obligations by approximately 50% over the long term.

At the end of 2007, VaR was DKr3,051m (2006: DKr4,751m). VaR is calculated at a confidence level of 99.97% and a time horizon of one year. The calculation includes an adjustment for inflation risk. The significant reduction of VaR from 2006 to 2007 is the result of rising interest rates and the use of financial derivatives to reduce the interest rate risk.

Follow-up and reporting are based on a model that Danske Markets also uses when advising customers in the life insurance and pension sectors. The model assumes specific processes for the trend in the yield curve and share prices and a correlation between interest rates and share prices.

Input for the analysis of liabilities is based on demographic and economic calculation assumptions for the gross obligation, while input for assets consists of duration and the convexity of the pension portfolio's composition.

7.2.4 Capital requirements

Defined benefit plans are included in the capital base at fair value, which means that a substantial amount is deducted from the capital base. The capital requirements are covered by the ICAAP (see section 8.2).